IN THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF VIRGINIA
ROANOKE DIVISION

IN RE:	)	
	)	**CHAPTER 7**
ANTAEUS TECHNICAL SERVICES, INC.	)	**CASE NO. 99-02114**
	)	
DEBTOR	)	

MEMORANDUM DECISION

The matter before the court is the Trustee's Motion to Establish Bidding Procedures for the Sale of Certain Patents and Other Assets of the Debtor.

FINDINGS OF FACT

1. On June 21, 1999, an involuntary petition for relief under Chapter 7 of the Bankruptcy Code was commenced against the Debtor, Antaeus Technical Services, Inc. ("Antaeus") The case was converted to a Chapter 11 case on November 24, 1999. On February 17, 2000, an order re-converting the case to Chapter 7 was entered by this Court. Robert T. Copeland was duly elected, qualified and appointed Trustee for the Debtor.

2. On June 5, 2000, VBS Investment Pty. Limited ("VBS") filed a proof of claim alleging a secured claim in the amount of $8,334,800.04 plus interest, fees and costs.

3. The Trustee filed a Complaint against VBS, thereby commencing Adversary Proceeding 02-0029A, seeking to avoid preferential transfers of property and to subordinate security interests and claims on March 7, 2002.

4. On October 15, 2002, the Trustee filed an Objection to VBS's claim.

5. For purposes of discovery, the Objection to VBS's claim and Adversary Proceeding 02-0029A were consolidated by a January 15, 2003 order.

6. On June 10, 2004, the Trustee filed a Motion to approve a Settlement Agreement resolving all issues between the Trustee and VBS.

7. An order approving the Settlement Agreement was entered by the Court on July 19, 2004[1]. A true and correct copy of the Settlement Agreement is attached hereto as Exhibit A[2] and is incorporated by reference. The Settlement Agreement provided that if the Trustee sold the Debtor's assets prior to December 31, 2004, VBS would receive the first $1,000,000 of the net sale proceeds less the Trustee's fees and expenses which were not to exceed $100,000.[3] Additionally, VBS was entitled to a credit bid up to $1,500,000 at any sale of the assets prior to December 31, 2004. If the Trustee did not sell the Debtor's assets before December 31, 2004, the Settlement Agreement provided VBS with two options - pay the Trustee $50,000 for the assets before January 15, 2005 or be deemed to have released its lien on the assets and abandoned any claim in the Debtor's estate.[4] Furthermore, the Settlement Agreement provided it could be amended only by a writing signed by the parties and was to be governed and construed in accordance with the laws of the Commonwealth of Virginia.

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[1] Pursuant to a separate order of the same date, Adversary Proceeding 02-0029A and the Objection to VBS's claim was dismissed with prejudice.

[2] At the November 18, 2005 evidentiary hearing, counsel for VBS conceded that the Settlement Agreement is not ambiguous and that there was no misunderstanding among the parties at the time of execution as to what they were entering.

[3] Net sale proceeds in excess of $1,000,000 were to be paid in $150,000 increments alternating between the Trustee and VBS.

[4] VBS was to formally withdraw its claim and file all documents required to release its claim in any of the Debtor's property by February 15, 2005.

8. The Trustee suffered a heart attack on December 14, 2004 and returned to work on a limited basis on January 17, 2005.

9. The Trustee did not sell the assets before December 31, 2004 as provided for in the Settlement Agreement. VBS did not pay the Trustee $50,000 in exchange for the assets by January 15, 2005 nor did VBS formally withdraw its claim by February 15, 2005.

10. On January 13, 2005, Joel Walker, counsel for VBS, contacted Mark Esposito, counsel for the Trustee, by telephone requesting an extension of the January 15, 2005 deadline set forth in the Security Agreement. Mr. Esposito informed Mr. Walker that he did not have the authority to extend the deadline but that he believed the Trustee would be agreeable to extending the deadline to Monday, January 17, 2005.[5]

11. On Tuesday, January 18, 2005, Mr. Walker emailed Mr. Esposito stating that he had not spoken to the Trustee and asking if he should contact the Trustee directly.

12. On Thursday, January 20, 2005, Mr. Walker emailed Mr. Copeland asking the Trustee to contact him.

13. On January 26, 2005, Mr. Walker spoke to the Trustee by telephone. The Trustee agreed to continue his sale efforts and to provide VBS with a summary of his sale efforts.[6] The parties did not discuss specific provisions of the Settlement Agreement and no specific deadline was discussed. Mr. Walker testified that the parties "agreed to continue as they

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[5] At the evidentiary hearing in this matter, Mr. Walker testified in response to a question from the Court that VBS had not deposited the $50,000 purchase price stipulated in the Settlement Agreement in his firm's trust account or otherwise prepared to exercise such right of purchase.

[6] The Trustee provided VBS with a summary of his sale efforts on or about April 27, 2005.

had been." The Trustee testified that, in his mind, the parties were continuing the status quo.

14. The Trustee filed an Objection to VBS's claim on April 1, 2005 arguing that VBS's claim should be amended to reflect the Settlement Agreement. On April 26, 2005, VBS asked the Trustee to withdraw the Objection to VBS's claim without prejudice. The Trustee responded that the Objection could be resolved by VBS filing an amended proof of claim reflecting the terms of the Settlement Agreement. On April 27, 2005, VBS replied and explained to the Trustee that it would be forced to file a response to the Objection stating that the Trustee did not use his best efforts to comply with the terms of the Settlement Agreement. On May 2, 2005, the Trustee agreed to prepare an order dismissing the Objection to VBS's claim without prejudice to file a new objection at a later date and on July 12, 2005 such an order was entered by the Court.

15. On May 3, 2005, VBS offered to purchase the assets for $20,000. The Trustee responded that he had received a bid from Fred M. Leonard for $25,0000.[7]

16. VBS proposed to pay the Trustee $25,000 for the assets in an email dated May 19, 2005. In his email, Mr. Walker acknowledged that the Settlement Agreement would need to be modified and presented to the Court for approval. Mr. Walker testified that court approval would be necessary for such a change since $50,000 as provided in the Settlement Agreement had been noticed to creditors. The Trustee did not directly respond to VBS's offer. Instead, the Trustee advised VBS that he was going to consult his 702 Committee,

[7] When the Trustee received Mr. Leonard's written offer on May 6, 2005, it was only for $20,000. By email, the Trustee informed VBS of the change in Mr. Leonard's offer.

which subsequently approved VBS's offer.

17. Sometime in August 2005, JAR Acquisition, LLC ("JAR") contacted the Trustee regarding the purchase of the assets and serving as a stalking-horse bidder in a potential sale of the assets.. JAR subsequently conducted due diligence that included reviewing actual and potential liens, claims and encumbrances on the assets, negotiating and drafting the Letter Agreement entered into with the Trustee, and noticing the Trustee's Motion to approximately 1,100 parties.

18. On September 8, 2005, the Trustee informed VBS of JAR's interest in the assets and that JAR was coming to the Trustee's office in Abingdon to begin working on due diligence.

19. During JAR's due diligence review, the Trustee informed JAR of the Settlement Agreement between the Trustee and VBS. The Trustee described the Settlement Agreement as providing a sale proceeds distribution scheme. JAR requested a copy of the Settlement Agreement from the Trustee. Mr. Copeland testified that he told Mr. Shuster, one of JAR's attorneys, about the Settlement Agreement and that it was in full effect. He testified that he had no discussion of a right to credit bid with any purchaser. The Trustee further stated that he did not remember the credit bid provision of the Security Agreement; he recalled simply that it provided the first $100,000 of any sale proceeds would go the bankruptcy estate and the next $900,000 to VBS.

20. VBS offered to pay $50,000 pursuant to the Settlement Agreement on September 21, 2005. The Trustee did not directly respond to VBS's offer. Instead, the Trustee informed VBS that JAR had asked for a copy of the Settlement Agreement. The Trustee explained that he could not locate the Settlement Agreement in his file and asked VBS to provide

him with a copy.

21. On September 27, 2005, JAR entered into a quite detailed Letter Agreement with the Trustee for the purchase of the assets for $52,000.00. A true and correct copy of the Letter Agreement is attached hereto as Exhibit B and is incorporated by reference.

22. On October 5, 2005, the Trustee supplied Mr. Walker with a copy of the Letter Agreement he entered with JAR stating "[i]n preparing it neither of us had the settlement agreement. [Mr. Esposito's] file was in storage and I didn't have one from you, so in their due diligence lien search they kept telling me they could not find a lien and I told him we had found one and settled the issue, but since neither of us had the agreement, we used the language that we did." (JAR Exhibit E).

23. On October 6, 2005, the Trustee provided JAR with a copy of the Settlement Agreement. The Settlement Agreement has been on file with the Court since approximately June 10, 2004[8] and was available upon request to the Trustee, VBS, or JAR. Counsel for JAR conceded at the November 18, 2005 evidentiary hearing that his firm failed to ask the Court for a copy of the Settlement Agreement despite JAR's request for approximately thirty other documents filed in this case.

24. On October 4, 2005, the Trustee filed a Motion to approve the sale of certain patents and other assets of the Debtor to JAR subject to higher and better offers and to establish bidding procedures for the sale. A Motion to Expedite the hearing, which was scheduled for October 19, 2005, was also filed.

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[8]The Settlement Agreement was an Exhibit to the Trustee's Motion to Approve Compromise Settlement and Mutual Release filed on June 10, 2004. Additionally, the Settlement Agreement was attached to the July 19, 2004 order granting the Trustee's Motion.

25. On October 18, 2005, the day preceding the noticed hearing, VBS filed a response to the Trustee's Motion alleging that the Motion failed to include VBS's right to credit bid which is provided for in the Settlement Agreement approved by this Court on July 19, 2004. VBS's response was served on the Chapter 7 Trustee, the Chapter 7 Trustee's counsel and JAR's counsel.

26. VBS argues that "[b]ecause of the Trustee's inability to market the Assets and the desire to attempt to maximize the value of the Assets, the Trustee and VBS agreed to extend the Settlement Agreement and operate under its terms." (VBS' Resp. ¶6). In support of its position, VBS contends that a series of writings in the form of "email" communications between its counsel and the Trustee establish that such parties agreed to extend the Settlement Agreement and operate under its terms.

27. JAR filed a Memorandum in Support of the Trustee's Motion on October 18, 2005 arguing that pursuant to the express terms of the Settlement Agreement, VBS's right to credit bid expired as of December 31, 2004 and that VBS was deemed to have surrendered any claim in the Debtor's bankruptcy case as of January 15, 2005 when it failed to exercise its right to purchase the patent rights.

28. The Trustee's Motion was heard on October 19, 2005 and upon the Court's request was scheduled for an evidentiary hearing on November 18, 2005. At that time the Trustee, counsel for VBS, and counsel for JAR all appeared and testified. The Court took the matter under advisement to consider the documentary exhibits and testimony.

29. At that hearing Mr. Michael Shuster, one of JAR's attorneys, testified that although the September 27, 2005 Letter Agreement specifically referenced the VBS Settlement

Agreement, he had not then yet seen a copy of that document and understood from the Trustee that such agreement provided for a scheme of distribution applicable to such claim. He admitted that he was aware that a secured creditor generally has a right to "credit bid" in a bankruptcy sale pursuant to section 363(k) of the Bankruptcy Code. Accordingly, the Court finds that JAR, in entering into the Letter Agreement with the Trustee, did not rely upon the provisions of the Settlement Agreement which under their terms would have extinguished any rights of VBS in the property or the bankruptcy estate and that to the contrary it proceeded upon the understanding that whatever the rights of VBS might be under such Agreement, they continued to exist.

CONCLUSIONS OF LAW

Upon these Findings of Fact, the Court makes the following Conclusions of Law:

1. This Court has jurisdiction of this proceeding by virtue of the provisions of 28 U.S.C. §§ 1334(a) and 157(a) and the delegation made to this Court by Order from the District Court on July 24, 1984.

2. The determination of appropriate bid procedures for a sale of property of the bankruptcy estate is a "core" bankruptcy proceeding pursuant to 28 U.S.C, § 157(b)(2)(A) and (O).

3. As the Trustee and counsel for VBS contend, Virginia law clearly permits the parties to a written contract to modify or amend its provisions either orally or by a course of conduct, even when the contract specifies that it can only be amended by a written document signed by both parties. *See Reid v. Boyle,* 527 S.E.2d 137, 144-45 (Va. 2000).

4. In a bankruptcy case, however, when the Trustee has entered into a contract on behalf generally of the creditors of the bankruptcy estate after obtaining approval of the Court after a hearing upon notice to the creditors and other parties in interest, the right of the Trustee to agree to amend the provisions of that contract without notice to the creditors or approval of the bankruptcy court is subject to some limitations.[9] While the breadth of the Trustee's discretion to agree to modifications of such contracts may be difficult to define in the abstract, the Court concludes that a modification of a contract entered into after notice to those creditors and approval of the bankruptcy court which substantially and adversely affects the rights of those creditors under that contract on whose behalf the Trustee acts requires approval of the Court obtained after notice to the creditors and an opportunity to be heard. The Court concludes in this case that an extension of the deadlines in the Settlement Agreement after the two critical deadlines specified in such Agreement had already expired, which under the terms of that Agreement resulted in a bargained for abandonment by VBS of its rights in the principal asset of the bankruptcy estate and indeed its very claim in the case, was the type of modification which required notice to the creditors and court approval to be effective. The situation presented to this Court is far different, for example, than if the Trustee and VBS had agreed prior to December 31 that the Trustee needed more time to attempt to market the technology and the parties had agreed on a six month extension of the deadlines specified in the Agreement, or if, to take another example, VBS had actually tendered to the Trustee or his

[9] *See* Fed. R. Bank. P. 9019; *see also Bezanson v. Bayside Enter., Inc. (In re Medomak Canning),* 922 F.2d 895, 900-01 (1st Cir. 1990) (recognizing that an order approving a settlement has the same res judicata effect as any other order of the court).

counsel the $50,000 agreed price to purchase the patent rights and the parties then had agreed that it was in their mutual interest to permit the Trustee to continue his sale efforts and had agreed to a specific extension of the rights granted to both parties under the Agreement. The Court recognizes that the Trustee's heart attack on December 14 and his inability to return to the office until after the expiration of the January 15 deadline for VBS to exercise its purchase right put both the Trustee and VBS in a difficult situation, one quite understandable in its human dimensions. Nevertheless, the situation VBS now finds itself in is due more to its own unwillingness to exercise the right granted to it under the Agreement should the Trustee not effect a sale by December 31, the "Sale Termination Date," than to the Trustee's unavailability for approximately a month following his heart attack. Because the Agreement required that any sale be actually made by December 31 and that prior court approval of the sale had to be obtained, it had to have been obvious both to VBS and the Trustee by the beginning of December, before the latter's heart attack, that a qualifying sale was not going to take place. Just prior to the expiration of the January 15 deadline specified in the Agreement, counsel for VBS reached an understanding with the Trustee's counsel, perhaps subject to the Trustee's approval, of an extension of the January 15 deadline to January 17. Nothing happened on that date or before it to change that status and VBS made no effort to exercise the important right granted it in the Agreement. Why this is so is not made clear by the evidence, but the Court infers that VBS had serious doubts whether the patent rights in fact had actual realizable commercial value and on a rationale of, as the proverb goes, "don't throw good money after bad", decided that it didn't want to put even more money out to try and see

whether it might have more success than the Trustee in marketing the technology. No doubt this was a difficult decision for VBS to make, but having made it, whether consciously or by inattention to its own interests, valuable rights became vested in the bankruptcy estate by reason of the Settlement Agreement. One of those rights is the one which VBS seeks to assert in the matter before the Court, namely, the right to credit bid up to $1.5 million, although interestingly it did not serve the Objection asserting such right upon either the creditors generally or the Creditors' Committee specifically.

5. Although the Trustee testified at the evidentiary hearing that he did not consider a VBS right to credit bid to be inconsistent with the bid procedures contained in the Letter Agreement with JAR, the Court concludes that in actuality it is. Section # 12(a) of such agreement provided that "a competing offer must be on the same terms and conditions as the offer set forth herein". Subsection (h) of such section further provides, "All bids at the Auction must be made in increments of $5,000 and shall be made in cash." The Court simply cannot square those provisions with a right to credit bid by a competing bidder, albeit one delayed until at least $100,000 has been reached. While the Bankruptcy Code quite reasonably and appropriately recognizes a right to credit bid pursuant to § 363(k), such fact cannot alter the economic realities that an auction sale in which one bidder is an existing lender who does not have to put up new money, but can rely upon money previously advanced and which the lender has no other actual way to recover, is not a sale in which the bidders are on a level playing field. Such a sale is like getting into an auction in which the other party is actually the owner of the property being sold, whose interest is not in actually obtaining the subject property but in playing poker to see what is the

highest bid which the independent bidder is willing to make. In short, the owner wants to be not the winning bidder, but rather the next-to-last bidder to the highest bid any other cash bidder is willing to advance. It is quite evident from the documentation and VBS's course of conduct in this case that its sole interest is maximizing the value of its purported lien rights against the patents. It has only exhibited interest in actually making a bid to purchase the patents with "new" money when other potential purchasers have surfaced and has not demonstrated such interest when other interested parties were not to be found. There's certainly nothing wrong with that, but to accord VBS a right to credit bid inherently skews the proposed sale in which JAR agreed to act as a "stalking - horse" bidder, a status which JAR fully appreciated might prompt offers from other competing third party bidders, into quite a different auction sale than the one contemplated by and agreed to by the Trustee and JAR.

6. Even if the Court is in error in concluding that the Trustee did not have the authority to agree to an indefinite extension of the deadlines provided for after the two critical deadlines provided for in the Settlement Agreement had already expired, the Court concludes that VBS's later attempts to purchase the patents at a lower price than the one which had been agreed to in the Settlement Agreement demonstrates that its counsel and VBS did not enter into a definite agreement with specific terms for the extension of the deadlines but rather simply agreed to continue to operate under the terms of the agreement, something like an employee continuing to work for an employer under existing terms of employment after an employment contract has expired. The problem with that is that VBS wanted to continue to operate under the Agreement when to do so served its economic

interest but to operate outside of it (e.g., to make an offer of $25,000 to purchase the patent rights) when that seemed to serve better its economic interests. In summary, VBS wanted to stay "in the game" but without attempting to either comply with or enforce the terms of the Agreement which it had reached the preceding year with the Trustee. The Court concludes that such conduct results in an abandonment of the Agreement and of any right to demand the opportunity to "credit bid" against JAR's efforts to purchase the Debtor's technology rights.

7. VBS has challenged the standing of JAR, which after all is interested in removing from the playing field as much competition as possible, to challenge its right to credit bid at the auction. The Court concludes that the expenditures of effort and money made by JAR to reach the Letter Agreement with the Trustee and its contractual commitment under such agreement to purchase the assets to be sold for $52,000 or such higher price as it might be willing to offer at an auction sale with other bidders operating under precisely the terms and conditions set forth in the agreement, clearly give JAR standing to object to a modification of the agreed bid procedures which would give one potential bidder a right to compete against it on a "credit bid" rather than purely new cash basis.

8. It is only necessary for the Court at this point to deal with the asserted right of VBS to credit bid. The Court need not and does not decide here whether VBS retains any distribution rights under the Settlement Agreement.

9. By separate order the Court will approve the proposed bidding procedures generally. Due to the passage of time while the issue in dispute has been litigated and then determined by the Court, however, it is not possible to approve bid procedures which contemplate an

actual sale hearing on December 7. Accordingly, in that respect only, the Court will deny approval and leave JAR and the Trustee to make an alternative proposal, if they agree to do so, which is feasible at this point in time and will result in the opportunity for a fully competitive auction sale of the patent rights of the nature originally contemplated by both JAR and the Trustee in the September 27 Letter Agreement to which they agreed.

This 6th day of December, 2005.

William F. Stone, Jr.
UNITED STATES BANKRUPTCY JUDGE